

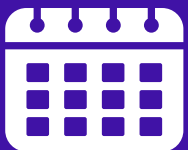
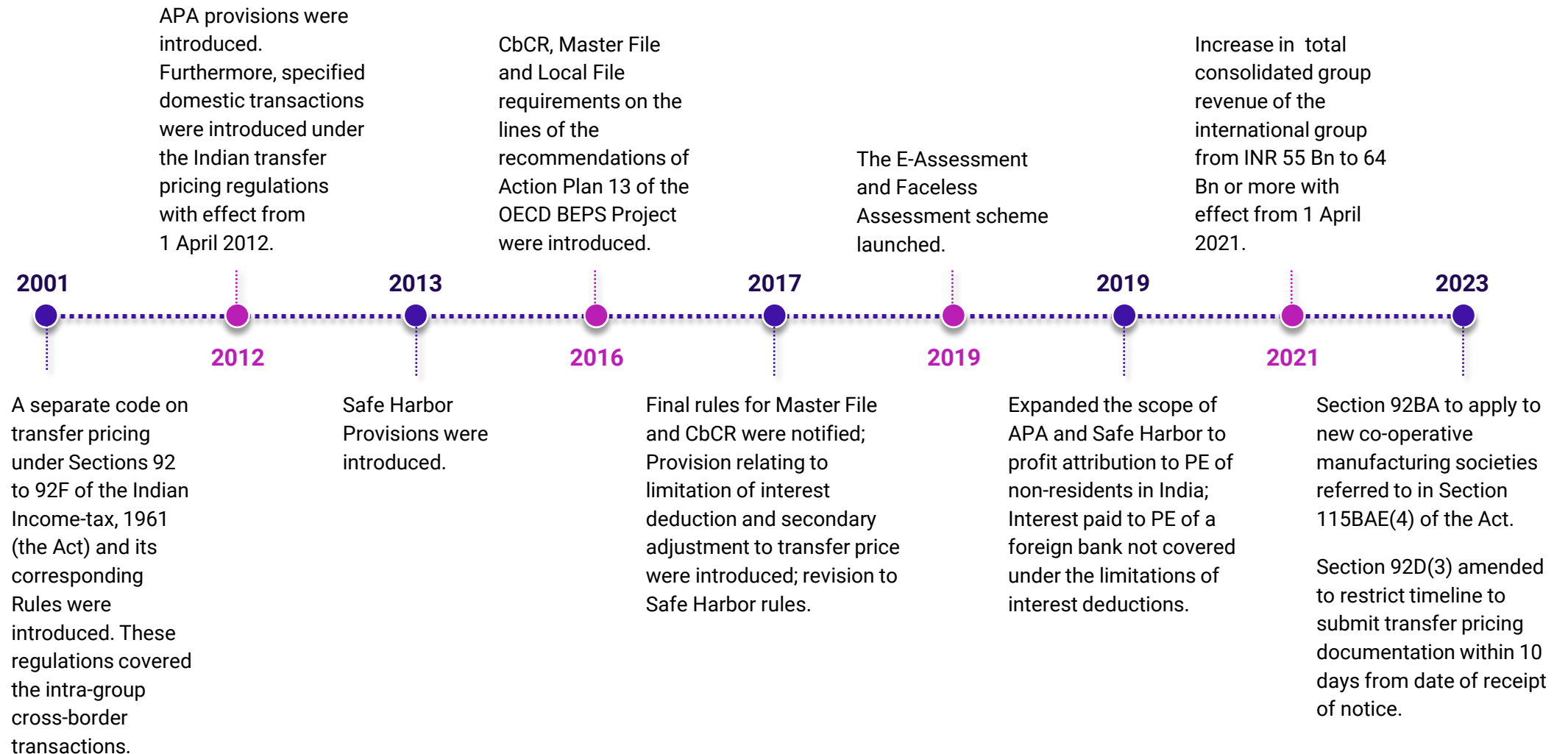
Global Transfer Pricing Landscape

India

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Highlights



Introduction

In India, detailed provisions on transfer pricing were introduced by the Finance Act, 2001. These generally follow the Organisation for Economic Co-operation and Development OECD guidelines to keep the Indian provisions in line with the global practices. The transfer pricing provisions are derived from Section 92 of the Act, which provides that the price of any transaction between Associated Enterprises (AEs), either or both of which are non-residents for tax purposes (international transactions), shall be computed having regard to the arm's length principle. The Finance Act, 2014 widened the scope of 'deemed international transactions' under the purview of transfer pricing.

The Indian transfer pricing regulations have changed to incorporate the key recommendations of OECD Base Erosion and Profit Shifting (BEPS). The annual budget of 2016 had incorporated several modifications, and now the transfer pricing documentation and reporting is principally in line with the OECD (BEPS) Action Plan 13 and is applicable from FY 16-17.

Associated Enterprises

Two enterprises are considered AEs if there is direct/indirect participation in the management or control or capital of an enterprise by another enterprise or by the same persons in both the enterprises. The provisions also include certain conditions wherein two enterprises are deemed as AEs. The criteria specified for determining AE relationships are:

- Having direct or indirect or common shareholding of 26% or more;
- Loans of over 51% of the book value of total assets of the borrower;
- Guarantee of 10% of the total borrowings;
- Appointment of more than half of the board of directors.
- Manufacturing or Sourcing dependency;
- Few other criteria citing control and mutual interest;

With regards to the Specified Domestic Transactions (SDT), tax holiday units of an entity transacting with other units as well as transactions with new manufacturing companies having lower effective corporate tax rate (vide Section 115BAB) are also under the purview of India transfer pricing. SDT provision shall also apply to new co-operative manufacturing societies (vide Section 115BAE) which have been extended concessional tax regime of 15%.

Transactions Covered

The regulations cover international transactions as well as certain specified domestic transactions (which may result in a tax arbitrage) in case the value exceeds INR 200 million. International transactions would include, apart from routine transactions relating to the purchase and sale of goods and services, transactions involving business restructuring, intangibles, goodwill, corporate guarantee, overdue debts, capital financing transactions, cost contribution arrangements, free of cost services, etc.

Furthermore, deemed international transactions cover certain cases where a taxpayer deals with a third party, which could also be deemed to be a transaction between the taxpayer and its AE. If there exists a prior agreement in relation to such a transaction between the third party and the AE or if the terms of such transactions are determined in substance between the third party and the AE. Therefore, even transactions between two resident and independent enterprises may be covered under transfer pricing regulations.

Arm's Length Price and Methods

An Arm's Length Price (ALP) according to the regulations is a price, which is applied or proposed to be applied in a transaction between a person other than the AE in an uncontrolled transaction. The ALP must be determined using any of the following six methods:

- Comparable Uncontrolled Price Method;
- Resale Price Method;
- Cost Plus Method;
- Profit Split Method;
- Transactional Net Margin Method; and
- Other methods as may be prescribed by the Board (the authority monitoring the direct taxes in India)

The regulations do not give preference to any specific method or methods, and the taxpayers are independent to choose the most appropriate method out of the six transfer pricing methods.

Usage of multiple year data and range

To enhance the reliability of the comparability analysis, taxpayers need to examine multiple year data as opposed to single-year data in order to evaluate factors that influence transfer prices, such as long-term arrangements, business/product life cycles, etc.

Furthermore, taxpayers can use the inter-quartile range (35th to 65th percentile) if the dataset contains more than six comparability data points.

However, if the dataset contains less than six comparability data points, taxpayers need to use the arithmetical mean to ascertain the ALP, wherein a tolerance range of 1% for 'wholesale trading' and 3% for all other transactions is also allowed vis-a-vis the ALP. 'Wholesale trading' has been defined to include -

- Where the purchase cost of finished goods is at least 80% of the total cost of such trades;
- The average monthly closing inventory of such goods must be 10% or less of sales from such trading activities.

Transfer Pricing Documentation BEPS Report/CbCR Applicability

Three tiered documentation approach

The transfer pricing documentation requirements have been substantially revised to align with the Action plan 13 of the OECD BEPS project, in which a three-tiered documentation viz. Country-by-Country Reporting (CbCR), Master File and Local File was introduced.

The Local File

The current disclosure requirements as prescribed under Rule 10D (i.e., the Local File) require mandatory preparation of a documentation report if the aggregate value of the reportable transactions exceeds INR 10 million. Furthermore, there is no specific format prescribed for documentation, but it should include the following information:

- Detailed description of the company (organization structure, operational aspects, competitors, description of business environment ownership structure, etc.);
- A profile of the multinational or group of which the company is a part of, along with certain details (such name, address, business, etc.);
- Transaction details such as nature and terms, quantum and value of each such transactions;

- A description of functions performed, risks assumed and assets employed by the company and by the associated undertaking involved in the transaction;
- Comparability analysis - selection of comparables; and
- Application of transfer pricing methods selected by taxpayers along with reasoning for rejection of other methods.

A taxpayer (falling within the thresholds above) is required to keep contemporaneous documentation in the English language for demonstrating the arm's length nature of the international transactions and specified domestic transactions (collectively referred to as a related-party transaction). The record-keeping, i.e., retention of the documentation, should be for a period of eight years from the end of the relevant year of assessment.

For comparability analysis, the taxpayer can use publicly available databases to arrive at an ALP and appropriate adjustments need to be made if necessary.

The databases widely used are maintained by private companies, while the corporate filings of companies are available on the public portal, namely, the Ministry of Company Affairs (MCA).

The newly introduced three-tiered documentation requirement enhances the information required vis-à-vis the current disclosure requirements as follows:

Master File (Rule 10DA) would provide an overview of the MNE business, including the nature of its global business operations, its overall transfer pricing policies, etc in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

Forms	Threshold	Timeline	Particulars
Form 3CEAA - Part A	No Limit	On or before the due date for filing of Return of Income (30 November)	To be filed by every constituent entity of the international group.
Form 3CEAA - Part B	Consolidated revenue of International Group exceeds INR 5 billion AND		To be filed by the constituent entity passing the prescribed threshold
Form 3CEAB (Intimation)	a. Aggregate value of international transaction exceeds INR 500 million OR b. Aggregate value of international transaction pertaining to intangible property exceeds INR 100 million	30 days prior to the date of filing of Master File.	Where there are multiple constituent group entities in India the group can designate one Indian entity to file the Master File in India provided intimation is made in Form 3CEAB.

Key forms, timeline and thresholds

The CbCR (Rule 10DB) requires aggregate tax jurisdiction wide information of the global allocation of revenue, profit & loss before income tax, tax paid and accrued, stated capital, accumulated earnings, number of employees, tangible assets other

than cash and cash equivalent of each entity as well as the details of each constituent entity of the group including the country of incorporation and tax residency and the nature of main business activity.

Forms	Threshold	Timeline	Particulars
Form 3CEAC	Consolidated group turnover exceeds INR 64 billion	Two months prior to furnishing the CbCR	Intimation of details of parent entity/alternate reporting entity which will file the CbCR
Form 3CEAD		The due date for furnishing the CbCR is 12 months from the end of the relevant accounting year	Filing CbCR in India is obligatory - Every parent entity or the alternate reporting entity resident in India OR parent entity situated in a country where CbCR filing is not obligatory or with which India does not have an automatic exchange of CbCR arrangement
Form 3CEAE (Intimation)		No timeline mentioned in the rules. This needs to be clarified by the CBDT.	Intimation of multiple constituent group entities in India

Furthermore, India notifies the Multilateral Competent Authority Agreement (the Agreement); it briefs out the mechanical procedure to be followed for the exchange of the CbCR between Competent Authorities of various jurisdictions who are a party to this Agreement. All the information exchanged by virtue of this Agreement would be limited to permissible uses like assessing high level transfer pricing, BEPS related risks and for economical and statistical analysis.

Reporting and Compliance

Report from a Chartered Accountant

Section 92E of the Act provides for a requirement of furnishing a report from a Chartered Accountant (CA/CPA) containing the details of transactions with AE (in Form 3CEB) by 31st October every year. The report would confirm the arm's length nature of the related party transactions and the disclosure as required to be made in the prescribed format.

Filing Form 3CEB in case of international transactions is mandatory (without any exemption).

Transfer pricing audit/assessment

The risk parameters used by the tax officer while selecting cases for detailed scrutiny may include the following areas:

- Intra-group services/management fees transaction;
- Financial transactions (especially corporate guarantee);
- Royalty/technical fees of any nature;
- Captive services (back-office, R&D, investment advisory);
- Loss situations

Furthermore, 'Transparent Taxation' scheme was launched in 2019 aimed at easing compliances, that introduced:

- a. Faceless Assessment Scheme, 2020 (effective from 13 August 2020);
- b. Faceless Appeal (effective from 25 September 2020); and
- c. Taxpayer's Charter (effective from 13 August 2020) containing revenue authorities' commitments towards taxpayers and duties of/expectations from taxpayers.

APA, MAP and Safe Harbor Procedures

The Advance Pricing Agreement (APA) program was introduced in 2012 in India. APA refers to an agreement between the taxpayer and the tax authority to determine the ALP or the manner of determining the ALP with regards to an

international transaction entered into by the AEs. Taxpayers may apply for unilateral, bilateral or multilateral APA for a period of five years. Moreover, taxpayers can also apply for roll-back provisions for four preceding financial years.

Taxpayers may also apply for Mutual Agreement Procedure (MAP), an alternative available to resolve disputes arising from double taxation between countries, within the given time limit as may be applicable according to the relevant tax treaty. The authorities have provided that attempts shall be made to resolve the tax disputes within an average time of 24 months.

Safe Harbor procedures have been notified and currently provide for circumstances in which certain transactions like Information Technology (IT)/Information Technology Enabled Services (ITES) services, contract R&D services, provision of corporate guarantee, manufacture of automobile components, and financial transactions in the nature of loans and guarantees are covered. If these are opted for, the Indian tax authorities, subject to the fulfillment of certain conditions, would automatically accept whereby the transfer prices declared (in line with the provisions).

The Safe harbor rules were recently amended to include an additional category of intragroup transactions viz receipt of low value added intra-group services. Furthermore, the amended rules have revised the thresholds for eligible international transactions and also amended the acceptable Safe Harbor price in certain cases.

Finance Act 2020 has extended the benefit of APA and safe Harbor coverage to attribution of profits to PE of non-residents in India, i.e., taxpayers who formally concede a business connection or PE in India can opt for safe Harbor rules or apply for APA in order to obtain certainty on profit attribution to PE in India.

Secondary Adjustment Mechanism

The Finance Act 2017 introduced the concept of secondary adjustment vide Section 92CE. The provisions related to secondary adjustments are applicable in the case where primary adjustments exceeding INR 10 million are made to a transfer price, either suo moto by the taxpayer or by tax authorities or as a result of APA, MAP, or Safe Harbor rules.

The aforesaid provisions are applicable from AY 2017-18 onwards. Accordingly, whereas a result of a primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss of the taxpayer, the 'excess money' (i.e., the difference between the ALP determined in the primary adjustment and the price at which the international transaction has actually been undertaken) which is available with its AE, needs to be repatriated into India within the prescribed time limit of 90 days from the date specified as per the rules. Else it will be treated as an advance/loan given to the AE, which will attract a notional interest (separate interest rates for transactions denominated in INR and in foreign currency, respectively).

Penalties and Other Consequences of Non-compliance

In case of any lapses/adverse inferences drawn by the transfer pricing officers, penalties linked to the value of transactions are attracted. The penalties, circumstances under which they shall be attracted, and their quantum are mentioned below:

Nature of penalty	Penalty
Failure to maintain documentation	2% of value of the international transaction entered into between related parties
Failure to furnish documentation to tax authorities, when called for	
Failure to disclose a transaction in the CA's report (Form 3CEB)	INR 100,000
Failure to furnish CA's report (Form 3CEB)	
For under-reporting of income	50% of the amount of tax payable on underreported income
For misreporting of income including failure to report any international transaction or related material facts	200% of the amount of tax payable on misreported income
Failure to furnish the Master File	INR 500,000
Inaccurate information filed under the CbCR	
Failure to furnish the CbCR or further information as called for	INR 5,000 - 50,000 per day depending upon period of delay

Section 94B- Limitation of Interest benefit (Deduction)

In conformance with OECD BEPS Action plan 4, the Finance Act 2017 introduced Section 94B- “Limiting Base Erosion Involving Interest Deductions and Other Financial Payments” where an Indian company or PE of a foreign entity as a borrower pays interest exceeding INR 10 million in respect of debt issued/guaranteed (implicit or explicit) by a non-resident AE. The provisions intend to disallow interest expense in ‘excess’ of 30% of the earnings before interest, tax, depreciation and amortization subject to actual interest expense. However, the same shall be available to be carried forward for a period of eight years and will be allowed as a deduction in subsequent years. The above restriction is not applicable to banking and insurance companies.

The Finance Act 2020 suggested another exclusion of interest charges incurred by the taxpayer and paid for debt issued by a lender, which is a PE of a non-resident engaged in the business of banking in India.

The Finance Act 2023 further extended relief on account of restriction of interest deduction under Section 94B to notified non-banking financial companies.

Summary of Transfer Pricing Requirements

Effective from

April 2001

Compliance Requirements

- The accountant's report under Section 92E of the Act to be filed by 31st October of the relevant assessment year
- Master File and CbCR as per rules 10DA and 10DB of the Income tax rules is required to be filed subject to the prescribed threshold limits effective from FY 2016-17
- Contemporaneous documentation to be maintained as referred to in Section 92D of the Act.

Penalties

Penalties that would be imposed are:

- It can range from 100% to 300% of the tax on an addition to the income.
- 2% of the value of the transaction entered into between related parties.
- INR 100,000 for non-furnishing of prescribed accountant's report.
- NR 500,000 for non-furnishing of Master Files within due date or inaccurate details filed under CbCR

- INR 5,000 to INR 50,000 per day for non-furnishing of CbCR

Method and Preference for Comparable

- Six methods
- Preference for local comparables

Peculiar features

Maintenance of contemporaneous documentation is not applicable where the aggregate of the international transactions does not exceed INR 10 million.

Three-tier transfer pricing documentation viz. Master File, Local File and CbCR were adopted by amending Section 92D and the insertion of Section 286 to Income tax Act; applicable subject to the prescribed threshold limits with effect from FY 2016-17.

APA, MAP and Safe Harbor

Available

BEPS/CbCR Applicability

Applicable, with effect from 1 April 2016, Automatic Exchange of CbCR information with all other Competent Authorities of Jurisdictions who are a party to Multilateral Competent Authority Agreement on annual basis.



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